COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Petition of Boston Edison Company, d/b/a NSTAR Electric, for Approvals Relating to the Assignment of Power Purchase Agreements with Ocean State Power and Ocean State Power II	)	**D.T.E. 04-68**

INITIAL BRIEF OF THE ATTORNEY GENERAL

Respectfully submitted,

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October 26, 2004

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I. INTRODUCTION

This case concerns a Petition ("Petition") by Boston Edison Company ("Boston Edison"), d/b/a NSTAR Electric (the "Company" or "NSTAR Electric"), for Department approval of the assignment of two existing power purchase agreements ("PPAs") with Ocean State Power ("OSP") and related rate recovery.

II. PROCEDURAL HISTORY

On July 16, 2004, pursuant to G.L. c. 164, §§1A, 1G, 76, 94 and 94A, NSTAR Electric filed a Petition with the Department for approval of a Purchase and Sale Agreement between Boston Edison and TransCanada Energy Ltd. ("TransCanada") that would assign the existing PPAs with OSP. On September 8, 2004, the Department conducted a public hearing and a procedural conference to establish a schedule for discovery, hearings and briefs. At this conference, the Department granted full intervenor status to TransCanada Energy Limited, ProGas Limited and Cape Light Compact.

The Department conducted an evidentiary hearing on October 14, 2004. During the evidentiary hearing, NSTAR Electric presented two witnesses to testify in support of its proposal, Geoffrey O. Lubbock, Vice President of Financial Strategic Planning and Policy for NSTAR Electric, and Robert B. Hevert, President of Concentric Energy Advisors, Inc ("CEA").

III. THE COMPANY'S PROPOSAL

In 1985 and 1988, Boston Edison entered into PPAs with Ocean State Power. *See* Exh. NSTAR-BEC-GOL-1A and Exh. NSTAR-BEC-GOL-1B. Both the 1985 PPA ("OSP 1 Agreement") and the 1988 PPA ("OSP 2 Agreement") are cost of service based contracts for delivered energy and capacity and the Company is obligated under each to purchase 23.5 percent of the summer and winter energy and capacity from OSP. Exh. NSTAR-RBH, p. 24. The OSP 1 Agreement has an initial twenty-year term beginning on December 31, 1990 and ending December 31, 2010. *Id*. The OSP 2 Agreement terminates on September 30, 2011. *Id*.

The Company conducted an auction for all of the Company's remaining PPA contracts and received only one bid that included the OSP contracts. Based on that bid, the Company determined[1] that the Purchase and Sale Agreement with TransCanada created a reduction in above-market costs.[2] *Id*. at 22. On June 23, 2004, the Company and TransCanada executed the Purchase and Sale Agreement that is the subject of the Company's Petition.

[1] Working with its consultant CEA, the Company assigned a market value to the OSP PPAs using variables including (1) the variable cost for fuel supply and transportation, (2) the demand and investment costs, and (3) the market price of energy and capacity. Exh. NSTAR-RBH, p. 25. CEA used a discount rate of 7.82 percent for the evaluation of these contracts and bids. *Id*.

[2] The Company calculated above-market costs as the present value of the difference between its forecast of the total cost under the existing PPA terms and the market value based on the Henwood Energy Service Inc.'s ("Henwood") Northeast Electricity and Gas Price Outlook for Fall 2003, with updates in March and May, 2004 for years 2004 through 2006 ("Northeast Electric and Gas Price Forecast"). Exh. NSTAR-RBH, pp. 18-19.

If the Department approves the Purchase and Sale Agreement, TransCanada would permanently assume all of the Company's obligations to purchase electricity under the OSP PPAs. The Company would make monthly support payments totaling approximately $151.56 million to TransCanada between April 1, 2004 and the end of the contracts. The Company states that its petition will result in approximately $12 million in customer savings on a net present value basis.[3] The Company also asks the Department to approve its proposal to pass the costs relating to the Purchase and Sale Agreement through its transition charge.

IV. STANDARD OF REVIEW

The Company is required to seek to mitigate to the maximum extent possible the total amount of transition costs recovered and to minimize the impact of recovery of transition costs on ratepayers. G.L. c. 164 §1G(d)(1) (the "Restructuring Act"). Mitigation efforts in which the Company must engage include (1) "...good faith efforts to renegotiate, restructure, reaffirm, terminate or dispose of existing contractual commitments for purchased power which exceed the competitive market price for power..."; (2) "...examination and analysis of the historic level of performance over the life of such contractual commitments for purchase power, regardless of whether or not they exceed the competitive market price..."; and (3) "...any other mitigation and analytical activities which the department determines to be reasonable and effective mechanisms for reducing identifiable transition costs." G.L. c. 164 §1G(d)(1)(ii), (iii), (vi).

According to the Restructuring Act, the Department, beginning July 1, 1998, and at least

[3] The Company's $12 million savings estimate is based on the Henwood energy forecasts from the spring of 2004. The Attorney General requested and the Department ordered the Company to update the energy forecasts used in its analysis of the contract assignment as well as the determination of the resulting savings. Exh. RR-DTE-6.

annually thereafter, shall review purchased power contracts approved on or by December 31, 1995 in order to determine if the contracts contain a price for electricity that is above-market as of the date of review. G.L. c. 164 §1G(d)(2)(i). If the Department determines a contract to be above-market, the electric company and the seller shall attempt to make a good-faith effort to renegotiate the contract in order to achieve further reductions in the transition charge. G.L. c. 164 §1G(d)(2)(i).

When evaluating the divestiture of generation assets, the Department reviews whether the divestiture process was equitable and structured to maximize the value of the assets being sold. *Cambridge Electric Light Company and Commonwealth Electric Company / Pittsfield Generating Company, L.P.*, D.T.E. 04-60, p. 21 (2004), *citing Western Massachusetts Electric Company*, D.T.E. 00-68, p. 12 (2000). The Department has relied on the auction process to determine whether a transaction involving a non-generating asset maximizes mitigation of transition costs. D.T.E. 04-60, p. 21. Also, the Department determines whether a company has indeed maximized the level of mitigation. *Cambridge Electric Light Company/Canal Electric Company/Commonwealth Electric Company*, D.P.U./D.T.E. 97-111, p. 64 (1998). The Department is authorized to approve the recovery of costs associated with a contract restructuring if the buyout is likely to achieve customer savings and is otherwise in the public interest. G.L. c. 164 §1G(b)(1)(iv).

The Department must also determine whether the proposed contract termination is reasonable. *See Plymouth Rock Energy Associates, L.P.*, D.P.U./D.T.E. 92-122-B (1999). In assessing the reasonableness of an agreement, the Department must review all available information to ensure that the agreement is consistent with the public interest and complies with the precedent governing buyouts of purchase power contracts. *Commonwealth Electric Company*, D.P.U. 91-200, p. 5-6 (1993); *Boston Edison Company*, D.P.U. 92-183 (1992) (Department approved termination agreement of a purchase power contract with Down East Peat, L.P.).

V. ARGUMENT

The Department should reject the Company's petition because the Company has failed to establish that, by entering into the proposed termination agreement, it met the maximum mitigation requirement of the Restructuring Act. The Company and CEA's valuation of the existing OSP contracts was flawed, rendering any savings projections speculative. In addition, by not appropriately valuing the existing contracts, the Company and CEA failed to properly evaluate the bid they did receive.

A. THE COMPANY AND CEA DID NOT ADEQUATELY DETERMINE THE VALUE OF THE OSP PPAS.

The Company and CEA did not adequately evaluate the terms of the existing OSP contracts in determining the value of the OSP PPAs. The OSP contracts contain provisions that grant the Company (1) the option to purchase the pro-rata portion of the plant, expected to be fully depreciated at the end of the contract; (2) the title to the Site Restoration Fund and the Seller's obligations to restore the site, expected to be more than $26 million at the end of the contract term ($26 million = $56 million x 47% BECo share); and (3) the right to any net gain, or the obligation to pay any net loss, from OSP's sale or transfer of the site to a third party. *See* Exh. NSTAR-BEC-GOL-1A, Section 5.6, p. 23 and Amendment 6, p. 2; Tr. 1, pp. 45, 58-59. These entitlements to potential future gains or payments in the contract clearly affect the contract.

Notwithstanding these entitlements, CEA did not assign any economic value to these contractual rights.[4] Tr. 1, pp. 43, 56 and 60. CEA claims that it is not necessary to consider these provisions because they are contingent and not guaranteed. Nevertheless, even with contingent claims, there is a probability that some or all of these events could occur but CEA made no attempt to value these probabilities.[5]

More importantly, CEA did not analyze whether the OSP units would be economic to operate in today's marketplace. Tr. 1, p. 41. Nor did CEA make a financial valuation of the OSP units in order to determine their worth. Tr. 1, p. 24. Given the various clauses in the existing OSP contract regarding the sale of the site (*See* Exh. NSTAR-BEC-GOL-1A), such an analysis would have provided important information about the value of the OSP units in the future, information that affects the valuation of the existing OSP contracts. By failing to conduct this analysis, CEA did not assign a proper value to the existing OSP contracts. An inadequate valuation of the existing contracts undermines the very basis on which the Company and CEA conducted their negotiations with bidders, including TransCanada. By incorrectly valuing the existing OSP contracts, the Company and CEA have failed to demonstrate that the termination agreement mitigates the transition costs to the maximum extent possible. Therefore, the Department should not approve the Company's Petition.

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[4] In evaluating the clause regarding the site restoration fund, CEA only considered the Company's pro-rata expense of contributing to the fund. Tr. 1, p. 56.

[5] CEA claims that (1) the Company and CEA had no reason to assume that the option to purchase the pro-rata portion of the plant would be exercised (Tr. 1, p.43); (2) the estimated costs of site restoration would equal the balance of the site restoration fund so the Company would not realize any gain from the fund (Tr. 1, pp. 51-52); and (3) too many conditions in the sale of land clause created uncertainty as to whether the Company would either realize a gain or suffer a loss (Tr. 1, p.60).

B. THE COMPANY AND CEA FAILED TO PROPERLY EVALUATE THE BID RECEIVED FOR THE EXISTING OSP CONTRACTS.

Because the Company and CEA did not assign the correct value to the existing OSP contracts, they failed to appropriately evaluate the bid they received for those contracts. Without the proper evaluation of the bids, the Company and CEA could not know if they indeed maximized the level of mitigation in the above market costs. G.L. c. 164 §1G(d)(1). The Company and CEA received initial bids on the entire portfolio of the Company's PPA entitlements, but only one participant submitted a final bid for the existing OSP contracts.[6] Tr. 1, p. 31. That sole participant is TransCanada, the owner and operator of the OSP generating facility. Exh. NSTAR-RBH, p. 24. The Company never attempted to determine the reasons that no other party put in a bid for the Ocean State Power contracts, either in the initial or in the final round of bids. Tr. 1, p. 33. The Company was content to accept this sole bid.

CEA states that "after extensive analysis and review..., it was determined that the TransCanada bid for the contract permanent assignment provided the greatest level of mitigation of the above-market costs associated with the OSP Contracts." Exh. NSTAR-RBH, pp. 23-24. No other bidder bid solely for the OSP contracts. Exh. NSTAR-RBH, p. 23. Any claim then,

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[6] In December 2003, the Company received only two initial bids for the complete portfolio of the Company's purchased power agreements, including the OSP contracts, and one initial bid for the OSP contract on a stand-alone basis from TransCanada. Exh. NSTAR-RBH, p. 23. According to CEA, the bids for the complete portfolio were subject to conditions, including due diligence inquiries. *Id.* Of these three bids, the two portfolio bidders dropped out during the due diligence phase before ever reaching a point where they could make a final bid. This left only the one bidder, TransCanada, which made the one and only final bid.

that TransCanada's single bid provides the greatest mitigation is, at best, speculative.[7] Comparing a bid that only values certain PPA entitlements with bids that value the entire portfolio results in a skewed determination of the market value of the OSP contracts. The Company and CEA could not compare the TransCanada bid to any comparable bid and, therefore, could not know if TransCanada's bid indeed provided the maximum mitigation of above-market costs. The Department, therefore, should reject the Company's Petition.

C. THE ATTORNEY GENERAL RESERVES THE RIGHT TO SUPPLEMENT THIS BRIEF BASED ON THE COMPANY'S UPDATES TO THE FALL 2004 HENWOOD STUDY.

The Department has asked the Company to provide updated calculations on schedules in its Petition after the Fall 2004 Henwood forecast numbers become available.[8] Tr. 1, pp. 153-154. These updated calculations may change the Company's Petition in terms of the customer savings. The energy market, including natural gas and oil prices, has changed drastically since the Company performed its analysis last spring. If, as anticipated, there are significant changes in the Fall 2004 Henwood forecast, the Company's calculations and assumptions regarding the estimated customer savings in this case will also change significantly. The Attorney General reserves his right to supplement this brief based on the results of these updates.

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[7] Given that the current OSP contractor was the only individual bid produced by the auction process, the Company could have renegotiated the terms of the existing OSP contracts with TransCanada and possibly achieved a maximum level of mitigation of above-market costs. G.L. c. 164, §1G(d)(1). Indeed, TransCanada submitted a bid in the 1999-2000 Initial Auction, but the Company apparently did not accept it nor engage TransCanada in renegotiating the existing OSP contracts. *See* Exh. AG-1-5(d) and (e).

[8] According to the Company, the Fall 2004 Henwood forecast will be available October 29, 2004. RR-DTE-1. In an open record request, the Department asked the Company to recalculate Exhibits NSTAR-GOL-BEC-2 through NSTAR-GOL-BEC-8, NSTAR-RBH-5 and NSTAR-RBH-6 to the extent that these exhibits change due to the Fall 2004 Henwood forecast. Tr. 1, pp. 153-154.

VI. CONCLUSION

For these reasons, the Department should reject the Company's Petition.

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